PEABODY COAL CO.

IBLA 96-438 Decided November 20, 1998

Appeal from a decision by the Minerals Management Service affirming a determination that the value of run-of-mine coal for royalty purposes must include the cost of reimbursed coal haulage from the pit to the grizzly, and assessing additional royalties for Federal Coal Lease No. C-19885. MMS 92-0040-MIN.

Affirmed.

1. Coal Leases and Permits: Royalties

The cost of transporting coal from the pit where it is severed to the grizzly and primary crusher is properly considered to be a cost of mining not permissible as a transportation allowance where the grizzly and crushing facility is located adjacent to the mine and most of the transportation occurs within the coal mine.

APPEARANCES: Brian E. McGee, Esq., Parcel, Mauro, Hultin & Spaanstra, P.C., Denver, Colorado, for Peabody Coal Company; Howard W. Chalker, Esq., Peter J. Schaumberg, Esq., Office of the Solicitor, U.S. Department of the Interior, for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE TERRY

Peabody Coal Company (Peabody) has appealed from a February 9, 1996, determination by the Associate Director for Policy and Management Improvement, Minerals Management Service (MMS), that upheld an MMS Royalty Valuation Order dated September 12, 1991 (Docket No. MMS-RVS-SMV: 89-0808), requiring payment of additional royalties on coal mined from Federal Coal Lease No. C-19885, at Peabody's Seneca II Mine in northwest Colorado. The question presented by Peabody's appeal is whether the cost of coal haulage from the pit to the Hayden Station grizzly qualifies for a transportation allowance and thus exempts the transportation cost from royalty calculations. We conclude that the value of such coal haulage must be included when making the royalty computation.

Peabody produces coal from the Seneca II Mine by surface mining methods, and sells it to the Hayden Station Power Plant (Hayden), pursuant

to a coal supply agreement with Hayden owners. Coal is loaded from the Seneca II Mine pit into trucks and hauled about 9.25 miles by road to Hayden, approximately 6.5 miles of which are on lease C-019885. There, Peabody delivers the coal run-of-mine, that is to say, "in a raw uncrushed state." (MMS Field Report dated Feb. 3, 1992, at 10.) At Hayden, the coal is dumped through a grid grizzly maintained by Peabody into Hayden's hopper which feeds the primary crushers, owned and chiefly maintained by Hayden. After primary crushing, the coal is run through a secondary crusher and then stockpiled. The coal is weighed for payment and royalty purposes while on conveyors at Hayden between primary and secondary crushing.

Citing Departmental regulations governing coal valuation on Federal leases that require lessees to place coal in marketable condition at no cost to the lessor, MMS found coal haulage to Hayden necessary to place coal in marketable condition; therefore, the cost of coal haulage to the Hayden crushing facility could not be deducted from gross proceeds in order to establish value for royalty purposes. (Royalty Valuation Order dated Sept. 12, 1991 (1991 Order), Encl. 1, at 5.) MMS concluded that, as coal haulage from the pit to the grizzly is normally a mining operation, Hayden had granted "noncash" consideration to Peabody, and that, under royalty valuation regulations, the cost of coal haulage to the grizzly must be added to the sales price of the coal to arrive at gross proceeds accruing to the lessee for royalty computation. Accordingly, MMS directed Peabody to make retroactive adjustments for past due royalties resulting from transportation allowances claimed for truck haulage from Lease No. C-19885 to the Hayden Station for the sales months September 1985 to date. (1991 Order at 1.)

Peabody appealed from this 1991 Order to the Director, MMS, asserting, as it had successfully in 1987, that the transportation allowance was necessary to arrive at the value of the coal at the mine, that it was error to conclude that Peabody was not entitled to a transportation allowance in calculating royalties payable on the lease, and that it was also error to deny that allowance retroactively. (1991 Supplemental Statement of Reasons (Supp SOR) at 3.) Peabody argued, before the Director, that Peabody cannot be denied the benefit of the deduction for transportation costs because of any previous failure to submit a transportation allowance request, since the 1987 MMS Decision that authorized a transportation allowance constitutes the final decision of MMS and is binding on MMS with respect to transportation costs both retroactively and in the future. (Supp SOR at 3-4.) Peabody further argued that fundamental principles of fairness in the administration of the Federal coal royalty program preclude a retroactive denial of a transportation allowance for the Lease. (Supp SOR at 4.)

The Associate Director rejected Peabody's arguments in part, although she did agree that the rule of administrative finality resulting from the 1987 MMS Decision precluded retroactive adjustments to the sales value for the audit period January 1980 through June 1986. (Decision at 10.) The

Associate Director found Appellant's arguments to be unpersuasive with regard to a transportation allowance after June 1986. She held, in pertinent part:

> In-mine haulage is generally understood as the movement of coal from pits or portals to crushing facilities, preparation plants, stockpiles, silos, or other storage or loading facilities. Here the coal is loaded in the surface pit within the mine and is transported by truck directly to the Hayden Power Plant, which is approximately 9.25 miles from the Federal lease surface pit and about 2.75 miles from the mine entrance. However, the actual distance from the pit to the destination is not a controlling factor. It is the relative distance from the mine and other relevant factors compared to normal mining practices in the area that control the determination that the destination is "* * * remote from both the lease and mine." (30 CFR 206.251 (1994)). The determination is subsequently made using the 4 criteria contained in the preamble to the March 1, 1989, Revision of the Coal Product Valuation Regulations, 54 F.R. 1492 (January 13, 1989).
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> I concur with RVSD's conclusion that transportation from the pit to Hayden Station constitutes in-mine transportation, for which no allowance is authorized. Loading the coal and moving the coal out of the pit so mining can proceed is common to all surface coal mines, as is the transportation to the mine facilities from the pit, or in this case, to the Hayden Station. These operations are necessary to place coal in marketable condition and must be performed at no cost to the lessee. As stated in the aforementioned preamble to the coal valuation final rules under criterion 2:
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> > The Minerals Management Service recognizes that it is not only a necessary industry practice to move coal to and from the various processing facilities but to also arrange for coal to enter the stream of commerce and for possession to transfer to the buyer. Transportation recognized as necessary to the operation of the mine would not qualify for transportation allowances.
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> Id. at 1503.
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> The intent of the regulations is clear, viz., moving coal from the pit is a necessary mine operation since coal transported from the pit is not in marketable condition, and in the instant case, this first segment of transportation to the mine facilities (grizzly and primary crusher) at the Hayden Station must be considered a mining operation, for which no transportation allowance is authorized.

(Decision at 6-7.)

On appeal to the Board, Peabody argues that MMS did not have the authority to vitiate the statutory, regulatory, and contractual characteristics and limitations of Peabody's "obligation" to pay a production royalty. (1996 SOR at 33.) Appellant claims that to the extent MMS is accorded such authority, the issuance of the 1991 MMS Demand Letter violates the doctrine of administrative finality and, therefore, is arbitrary, capricious, and an abuse of discretion. Id. In either event, Peabody argues that MMS failed to provide "fair notice" of its reversal of the 1987 MMS Transportation Allowance Decision until September 12, 1991. Id. For this reason, Appellant claims, the 1991 MMS Demand Letter must be vacated and remanded, with appropriate findings. (SOR at 34.)

In its Answer, MMS states that it is longstanding MMS practice to deny a transportation allowance for hauling coal in the vicinity of the coal mine, in particular, when that coal is not conditioned for market. (Answer at 3.) MMS further states that since the coal was crushed at Hayden, it was not in marketable condition when delivered to the Hayden primary crusher. (Answer at 4.) Consequently, MMS claims, Peabody must bear the cost of bringing the coal the short distance to Hayden because it is the lessee's duty to place the product in marketable condition. Citing California Co. v. Udall, 296 F.2d 384, 387 (D.C. Cir. 1961); Western Fuels-Utah, Inc., 130 IBLA 18 (1994); ARCO Oil and Gas Co., 112 IBLA 8 (1989); Walter Oil and Gas Corp., 111 IBLA 260 (1989). Also citing 30 C.F.R. § 206.257(h).

In its Answer, MMS states that its Decision denying Peabody a transportation allowance for the costs of hauling the coal to Hayden is consistent with the pre-1989 royalty valuation regulation at 30 C.F.R. § 203.200(f). MMS recites that the regulation states: "[T]he value of coal for Federal royalty purposes shall be the gross value at the point of sale, normally the mine." (Answer at 5.) MMS urges that if it gave Peabody a transportation allowance for the cost of transporting the coal to Hayden, then MMS would not be valuing Peabody's coal at the "point of sale." Id.

MMS states that effective March 1, 1989, it revised its Coal Production Valuation Regulations and clarified the rules concerning coal valuation for purposes of computing the royalty. (Answer at 7.) It claims that the conclusion that MMS should deny an allowance for all costs occurring prior to the sales point is reaffirmed in the preamble to the revised coal valuation regulations. The preamble states that "[u]nder normal mining conditions, all transportation occurring prior to an f.o.b. (free on board) mine sales point would be borne exclusively by the lessee." (Answer at 7, citing 54 Fed. Reg. at 1503.) MMS explains that the new regulations governing transportation allowances, which appear at 30 C.F.R. §§ 206.261 and 206.262 (1989), also prohibit an allowance for such costs. (Answer at 8.) The regulations state in pertinent part that "[i]n-mine transportation costs shall not be included in the transportation allowance." (Answer at 8, citing 30 C.F.R. § 206.261(a)(2).) Further, MMS explains, the preamble states that "[c]oal movement from the portals to the crushing

facilities * * * is considered part of the mining operation." (Answer at 8, citing 54 Fed. Reg. at 1503.) Thus, MMS claims, it was correct in disallowing costs associated with moving the coal to the crushing facility. (Answer at 8.)

[1] Federal Coal Lease No. C-19885 covering the Seneca II Mine requires Peabody to pay royalties as a percentage of the value of the coal produced, as defined by regulation. From July 1986, until March 1, 1989, the coal royalty valuation regulations provided that when "Federal royalty is calculated on a percentage basis, the value of coal for Federal royalty purposes shall be the value at the point of sale, normally the mine, except as provided at 30 CFR 203.200(h)." 30 C.F.R. § 203.200(f) (1987). The regulations further provided that if additional preparation of the coal is performed prior to sale, "the following shall not be deducted from the gross value for Federal royalty purposes: costs of primary crushing, storing, and loading; * * * and other preparation of the coal which in the judgment of the District Mining Supervisor do not enhance the quality of the coal." 30 C.F.R. S 203.200(h) (1987). The intent of the above quoted language was to disallow deduction of costs which, in the ordinary course of business, are necessary to render the coal marketable.

The Board addressed transportation allowances under the pre-March 1, 1989, regulations in Western Fuels-Utah, Inc., 130 IBLA 18, 29-32 (1994), a case cited by MMS in its Answer. In that case, the Board affirmed an MMS denial of a transportation allowance for the costs applicable to a conveyor belt used to transport the coal to the rail load-out that was located off-lease. Appellant in that case requested an allowance for the costs of hauling the coal to the rail loadout. In arriving at a transportation allowance, a distinction has traditionally been drawn between "in-mine transportation" and outbound (long-distance) transportation where sales occur at the destination rather than at the mine. A transportation allowance may be granted only for the costs associated with the latter. The requirement that a lessee perform normal in-mine haulage at no cost to the lessor is based on the principle that production from a Federal lease must be placed in marketable condition at no cost to the lessor. See California Company v. Udall, 296 F.2d 384 (D.C. Cir. 1961). We concluded in Western Fuels-Utah, Inc., supra, that MMS was correct in denying the request for a transportation allowance because the conveyor belt was part of Western Fuels in-mine transportation system, even though the load-out was located 1.2 miles off the lease. Western Fuels-Utah, Inc., supra, at 31.

Application of the transportation allowance under the pre-1989 regulations requires analysis of the facilities at issue. As recited above, a deduction is not allowed for certain types of expenses (primary crushing, storing, and loading). 30 C.F.R. § 203.200(h) (1987). The record indicates that Appellant requested a transportation allowance for the cost of truck haulage of coal for the 9.25 miles from the mine pit to the grizzly, primary crusher, and loadout point at the Hayden plant, although more than two thirds (6.5 miles) of this transportation occurred on the lease. The

terms of the relevant royalty valuation regulation barring a deduction for costs of storing and loading the coal reflect that loadout marks the end of the mining process. Id. Related regulations regarding production accounting define the term "mine" to mean "an underground or surface excavation or series of excavations and the surface or underground support facilities that contribute directly or indirectly to mining, production, preparation, and handling of coal or other solid minerals." 30 C.F.R. § 216.6(o) (1987). The definition of "facility" includes "a structure(s) used to store or process Federal or Indian mineral production prior to or at the point of royalty determination." 30 C.F.R. § 216.6(f) (1987). The point of royalty determination is the Hayden Station, and Article 22 of the 1971 Amended and Revised Hayden Coal Supply Agreement states that title of the coal passes at the Hayden Station. It appears from the record that the grizzly and primary crusher are located 2.75 miles off the lease at the Hayden Station for efficiency of operation. It is the obligation of the lessee to place the coal in marketable condition. This generally entails placing the coal in a loadout facility where the buyer can readily take possession. The fact that loadout of the coal occurred off lease but in close proximity to the lease in order to maximize efficient coal mining operations does not make the transportation involved here an allowable transportation expense. See Western Fuels-Utah, Inc., supra, at 31.

MMS published revised coal valuation regulations on March 1, 1989. While the revised regulations are more explicit in authorizing a transportation allowance (see 30 C.F.R. § 206.257(a)), we find the result on the facts of this case to be the same. The new regulations provide:

> "Transportation allowance" means an allowance for the reasonable, actual costs incurred by the lessee for moving coal to a point of sale or point of delivery remote from both the lease and mine or wash plant, or an approved MMS-initially accepted deduction for costs of such transportation , determined subject to this subpart.

30 C.F.R. § 206.251 (1989). The revised regulations provide in pertinent part:

> [W]here the value for royalty purposes has been determined at a point remote from the lease or mine, MMS shall, as authorized by this section, allow a deduction in determining value for royalty purposes for the reasonable actual costs incurred to:
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> (1) Transport the coal from a Federal or Indian lease to a sales point which is remote from both the lease and the mine; or
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> (2) Transport the coal from a Federal or Indian lease to a wash plant when that plant is remote from both the lease and the mine and, if applicable, from

> the wash plant to a remote sales point. In-mine transportation costs shall not be included in the transportation allowance.

30 C.F.R. § 206.261(a) (1989). MMS further sought to clarify what qualifies as "remote" facilities off the lease in the preamble to the revised regulations. 54 Fed. Reg. 1503 (Jan. 13, 1989). The preamble stated that coal transportation occurring "in what could reasonably be considered the vicinity of the mine, lease, etc. * * *"

> would constitute de facto mine haulage and would not qualify for a transportation allowance. Coal movement outside the lease boundary from where it was extracted but inside a larger encompassing mine boundary is not unusual. Any coal movement about the mine premise and between mine processing facilities is at the direction of the mine manager, who ultimately exercises control over the flow of coal from the point of extraction through all processing circuits and loading facilities.

Id. The preamble also noted that "[c]oal movement from * * * the portals (in the case of an underground mine) to crushing facilities, preparation plants, surge bins, stockpiles, silos or other storage, loading or sales facilities of the mine is common trade practice and considered part of the mining operation." Id.

The application of these principles to the present case dictates that the coal haulage to the grizzly and the primary crushing facility at the Hayden Station, in close proximity to the lease, are properly considered costs of mining rather than allowable transportation expenses.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the Decision appealed from is affirmed.

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James P. Terry
Administrative Judge

I concur:

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C. Randall Grant, Jr.
Administrative Judge